

A nonprofit organization that operates a cut-price retail grocery outlet and allocates a small portion of its earnings to provide on-the-job training the hard-core unemployed does not qualify for exemption from income tax.

Advice has been requested whether the activities of the organization described below qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 where the organization otherwise qualifies for such exemption.

The organization was formed to operate a retail grocery store to sell food to residents of a poverty area at prices substantially lower than those charged by competing grocery stores, to provide free grocery delivery service to residents who need it, to participate in the Federal food stamp program, and to provide job training for unemployed residents.

The store is operated by a staff of employees experienced in the retail food industry. The store is operated in a manner similar to profit-making businesses in the area, but has a smaller markup than the competing stores. The organization is organized as a non-profit corporation and no individual has any proprietary interest in its earnings. The store's gross earnings are used principally to pay salaries and other customary operating expenses incurred in the operation of a retail grocery store and to expand the operations of the store. About two percent of earnings is retained as surplus, to be used as a contingency reserve.

About four percent of the store's earnings is allocated for use in a continuous training program for the hardcore unemployed. The organization selects only individuals from the hardcore unemployed of the poverty area for training in the various jobs in a retail food store. The training program includes lectures, demonstrations of retail store techniques, and on-the-job training. A trainee receives a small salary during the training period. At the conclusion of his training, he is qualified for employment in the retail food industry. The organization does not plan for the majority of the trainees to continue as its employees. Rather, they are expected to seek employment elsewhere in the retail food industry and new trainees are selected for the program.

Section 501(c)(3) of the Code provides for the exemption from Federal income tax of organizations organized and operated exclusively for charitable or educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that to be exempt an organization must be both organized and operated exclusively for one or more exempt purposes.

Section 1.501(c)(3)-1(d)(2) of the regulations defines the

term 'charitable' as used in section 501(c)(3) of the Code as including the relief of the poor and distressed or of the under-privileged and the advancement of education.

Section 1.501(c)(3)-1(d)(3)(i)(a) of the regulations defines the term 'educational' as including the instruction or training of the individual for the purpose of improving or developing his capabilities.

The organization's purpose of providing job training for the hard-core unemployed is charitable and educational within the meaning of the common law concept of charity, section 501(c)(3) of the Code, and sections 1.501(c)(3)-1(d)(2) and 1.501(c)(3)-1(d)(3)(i)(a) of the regulations. However, the organization's purpose of operating a retail grocery store where food is sold to residents of a poverty area at low prices is not recognized as a charitable purpose under the basic common law concept of charity and within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(d)(2) of the regulations.

Although the nature of the job training in this case is primarily 'on-the-job' training and thus requires the existence of an operating business as its 'campus,' the size and manner of the food store operation and the facts relating to the actual purpose of the undertaking evidence that the operation of the store as a low cost retail grocery outlet is in itself an independent objective of the organization. This is true notwithstanding that the store operation is used in part as a vehicle for the training program. It is conducted on a scale larger than is reasonably necessary for the performance of the organization's training program and was not intended to, nor does it in fact, serve solely as a vehicle for carrying out the training program of the organization.

Neither may the store operation be characterized as an investment or business undertaking for the production of income for use in carrying on qualified charitable purposes of the organization. The facts show that such is not the purpose of the undertaking, but that the store is operated in part for the purpose of providing a low cost retail grocery outlet in the community as an end in itself.

Thus, it is concluded that operation of the store and operation of the training program are two distinct purposes, that is, ends or objects sought to be accomplished by the organization through use of its resources. Since the former purpose is not a recognized charitable purpose, the organization is not organized and operated exclusively for charitable purposes.

Accordingly, it is held that the organization does not qualify for recognition of exemption from Federal income tax under section 501(c)(3) of the Code.

Compare Revenue Ruling 78-128, this page, which holds that an

organization providing job training for certain residents of an economically depressed community may qualify as a charitable organization where the manufacture and sale of merchandise is the means by which it accomplishes its exempt purpose.